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Updates on Beneficial Ownership Reporting in the United States

Introduction

After an initial attempt to introduce a federal register of company beneficial owners in 2017, the United States passed the Corporate Transparency Act (the "Act") as part of the Fiscal Year 2021 National Defense Authorization Act (the "NDAA"). The House of Representatives and the Senate passed the NDAA in mid-December 2020; however, the bill was vetoed by President Trump on Wednesday, December 23, 2020. In its first veto override of President Trump's term, the House, on December 29, 2020, and the Senate, on January 1, 2021, passed the NDAA again by more than the two-thirds majority required.

The Act becomes another step towards placing the United States on similar footing with other similarly positioned OECD and FATF nations in requiring the reporting of the ultimate beneficial owners of companies and similar corporate entities and making such information available for certain anti-money laundering ("AML") and other countering of terrorist financing purposes, albeit with significant points of divergence notably related to scope and accessibility. The information gathered under the Act may be made available upon request to law enforcement agencies at federal, state and local level as well as from other non-US jurisdictions.

Summary of the Corporate Transparency Act

Collection of Information. The Act implements the collection of beneficial ownership information by requiring a "reporting company" to submit to the US Treasury Department's Financial Crimes Enforcement Network ("FinCEN") a report that identifies each "beneficial owner" of the reporting company and each "applicant" with respect to that reporting company. The specific identifying information that is required to be reported is each beneficial owner's and applicant's name, date of birth, current address, and unique identifying number from an acceptable identification document or FinCEN identifier.

The Secretary of the Treasury (the "Secretary") has broad regulatory authority under the Act and is required to promulgate such regulations within one year after the date of enactment, which is January 1, 2022. The regulations may have an effective date subsequent to January 1, 2022. As discussed below, there are a number of provisions of the Act that require regulatory action in order for their application to be clarified.

Definition of Beneficial Owner. "Beneficial owner" is defined as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, exercises substantial control over the entity or owns or controls not less than 25% of the ownership interests of the entity. Whether the beneficiary of a trust that holds an interest in a reporting company can be considered a beneficial owner is not clear, but presumably if it can be determined

that a beneficiary has at least a 25% interest in a trust that holds an interest in a reporting company, such a person would be a beneficial owner.

A beneficial owner does *not* include:

- a minor child if the information of the child's parent or guardian is reported in accordance with the Act,
- someone acting as a nominee, intermediary, custodian, or agent on behalf of another person,
- an individual acting solely as an employee of a corporation, limited liability company ("LLC"), or other similar entity and whose control over or economic benefits from such entity is derived solely from the employment status of the person, and
- an individual whose only interest in a corporation, LLC, or other similar entity is through a right of inheritance or a creditor thereof.

In order to prevent the beneficial owners of an entity from being obfuscated, the Act prohibits a corporation, LLC, or other similar entity formed under the laws of a US state or Indian Tribe from issuing a certificate in bearer form (i.e., a form where a certificate is issued without a name and whoever actually holds the certificate is the owner).

Definition of Applicant. As noted above, the information that must be reported under the Act includes that of the "applicant" as well as of the "beneficial owner." The applicant is the person who "files" an application to form a corporation, LLC, or other similar entity, or who registers or files an application to register a corporation, LLC, or other similar entity formed under the laws of a foreign country to do business in the United States. Therefore, if an advisor or agent of entity or the beneficial owner, such as an attorney, files the application for the entity, his or her information will be provided to FinCEN as well. The regulations need to clarify what it means to "file" the application for the entity.

Scope of reporting obligation. For purposes of the Act, "reporting company" means a corporation, LLC, or "other similar entity" that is created by the filing of a document with a secretary of state or a similar office under the law of a US state or Indian Tribe, or formed under the law of a foreign country and registered to do business in the US by the filing of a document with a secretary of state or a similar office under the laws of a US state or Indian Tribe.

An earlier draft House bill from 2019 limited its application to corporations and LLCs and did not reference "other similar entity" in the definition of the entities covered by the Act. The earlier version also specifically carved out certain other types of entities for later consideration.

Presumably the definition of the term "other similar entities" will be addressed by the Secretary in the required regulations under the Act. As discussed below, reporting under the Act is not required until after the regulations are issued. This should provide clarity in terms of whether entities that are not corporations or LLCs fall within the term "reporting company." The requirements for further study of beneficial ownership reporting with respect to partnerships and trusts (see "Future Studies" below) imply that partnerships and particularly trusts are more likely to fall outside the scope of "other similar entities", at least for the time being. However, the status of such other legal entities (including trusts for this purpose) will only become clear as implementing regulations are developed. It seems less

likely that at least common-law trusts would be included, as these are not considered entities for state law purposes generally. However, regulations could potentially include partnerships or even certain types of statutory trusts, such as business trusts and investment trusts, as "other similar entities". The study required as to other entity types may also lead to further legislative or regulatory updates expanding the scope of reporting companies at a later date. If the regulations do not provide such clarity, however, entities that are not corporations or LLCs may nevertheless decide to report under the act out of caution and to avoid penalty exposure.

With that said, note that in terms of defining the "applicant" of an entity the Act references the idea of *filing* an application to form a corporation, LLC, or other similar entity that is subject to the reporting requirements of the Act. This implies that a structure which is not formed by a government filing would not be a "similar entity" that is required to provide a beneficial ownership report under the Act.

Exceptions to Reporting Obligations. The Act itself does specifically carve out a number of entities from the definition of "reporting company." Such entities are relieved from the reporting obligations of the Act. Of the many carve outs, four are worth noting:

(1) An organization that is described in section 501(c) of the Internal Revenue Code ("IRC"), so long as it is exempt from taxation under the IRC. This includes charitable organizations, social welfare organizations, labor organizations, business leagues, chambers of commerce, and social clubs. Any such organization will be required to comply with the reporting requirements of the Act if it loses its tax exemption, although it will continue to be exempt from reporting for the 180-day period beginning on the date of the loss of its tax-exempt status.

(2) An entity that employs more than 20 employees on a full-time basis in the US; filed in the previous year federal income tax returns in the US demonstrating more than $5,000,000 in gross receipts or sales in the aggregate; and has an operating presence at a physical office within the US.

(3) A corporation, LLC, or other similar entity in existence for over one year that is not engaged in active business; that is not owned, directly or indirectly, by a foreign person; that has not, in the preceding 12-month period, experienced a change in ownership or sent or received funds in an amount greater than $1,000 (including all funds sent to or received from any source through a financial account or accounts in which the entity, or an affiliate of the entity, maintains an interest); and that does not otherwise hold any kind or type of assets, including an ownership interest in any corporation, LLC, or other similar entity.

(4) An entity that the Secretary, with the written concurrence of the Attorney General and the Secretary of Homeland Security, has, by regulation, determined should be exempt from the reporting requirements because requiring reporting for such an entity would not serve the public interest and would not be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes. Presumably the Secretary would take into consideration whether certain entities report beneficial ownership information already in other reports filed with the IRS and FinCEN, as discussed further below. This is contemplated by the Act itself, which provides that in promulgating

regulations the Secretary should collect beneficial ownership information through existing federal, state, and local processes and procedures and should minimize the burdens on reporting companies.

Reporting Deadline. As to the deadline for a reporting company to report beneficial ownership and applicant information to FinCEN, for a reporting company that has been formed or registered before the effective date of the regulations issued by the Secretary that implement the provisions of the Act, the company is required to provide such information to FinCEN not later than two years after the effective date of such regulations. As to a reporting company that has been formed or registered after the effective date of such regulations, the company is required to provide such information to FinCEN at the time of formation or registration.

In addition, as to any reporting company for which there is a change with respect to any beneficial owner information, the company is required to submit to FinCEN a report that updates the information not later than one year after the date on which the change occurred (this one year period could be reduced under regulations issued by the Secretary).

The important take away from these provisions is that the reporting requirements of the Act are not annual requirements. As such, for reporting companies which have few ownership changes the reporting under the Act should be infrequent and not over burdensome.

Maintenance and Disclosure of Information. A fundamental provision of the Act is that the Secretary maintain the beneficial ownership information collected in a secure, nonpublic database, using information security methods and techniques that are appropriate to protect nonclassified information systems at the highest security level. The Secretary is also required to take all steps to ensure that government authorities accessing such information do so only for authorized purposes consistent with the Act. Since the Secretary is already required to protect similar information from the public domain under the tax reporting system of the IRC, persons impacted by the Act should have confidence that the beneficial ownership information that is collected will remain confidential.

Specifically, the Act provides that beneficial ownership information may *not* be disclosed by an officer or employee of the US or of any state, local, or Tribal agency or by an officer or employee of any financial institution or regulatory agency receiving information under the Act.

However, FinCEN *may disclose* beneficial ownership information reported under the Act only *upon receipt of a request* from certain federal, state, or local agencies or to foreign governments if requested through a federal agency on behalf of a law enforcement agency, prosecutor, or judge of the other country under an international treaty, agreement, convention, or by way of certain other official requests when there is no such foreign agreement. Furthermore, the reporting company may consent the information to be provided to the financial institution subject to customer due diligence requirements in order to verify the beneficial ownership.

Potential Penalties. Any person who willfully provides, or attempts to provide, false, fraudulent, incomplete or not updated beneficial ownership information to FinCEN

(i) will be liable for a civil penalty of not more than $500 for each day that the violation continues or has not been remedied, and
(ii) may be fined not more than $10,000, imprisoned for not more than two years, or both.

Under the Act's safe harbor provision, a person will not be subject to these civil or criminal penalties if the person

(a) has reason to believe that any report submitted by the person to FinCEN contains inaccurate information (so long as the person was not trying to evade the Act's reporting requirements) and
(b) submits a report containing corrected information voluntarily and promptly, and in no case later than 90 days after the date on which the person submitted the report.

Future Studies

In addition to the requirements imposed upon reporting companies, the Act requires the Secretary to conduct certain further studies and reviews on the future enhancement and improvement of beneficial ownership information collection and reporting. These further studies should set the stage for additional measures regarding beneficial ownership information collection and reporting, potentially extending to trusts and partnerships, as well as fine-tuning the application of the existing measures applied to reporting companies, including the scope of these companies.

Annual Report of Changes in Beneficial Ownership. With respect to reporting changes of beneficial ownership, the Secretary is required, in consultation with the Attorney General and the Secretary of Homeland Security, to conduct a review and evaluate potential updated reporting. The scope of this review includes evaluating:

- the necessity to update regarding a change in ownership within a shorter period of time than the specified one-year period; and

- with respect to any such earlier deadline to report on changes of ownership, evaluating the benefit to law enforcement and national security officials, as well as the burden this requirement would impose on corporations, limited liability companies, or other similar entities.

The Secretary is then required, within two years from the date of enactment of the Act (a deadline one year following the general deadline to promulgate regulations generally as to the reporting obligations), to incorporate into the regulations, as appropriate, any changes necessary to implement the findings and determinations based on this required review.

Reporting on Standards and Procedures. Additionally, one year from the promulgation of the regulations concerning the information required to be reported, and annually for two years thereafter, the Secretary must report to Congress describing the procedures and standards prescribed to carry out the reporting of beneficial owner information. This report will include an assessment of (a) the effectiveness of those procedures and standards in minimizing reporting burdens (including through the elimination of duplicative requirements) and strengthening the accuracy of reports submitted and (b) any alternative

procedures and standards prescribed to carry out the required beneficial owner reporting.

Further Studies on Beneficial Ownership Information Reporting Requirements

In addition to the reporting required by the Secretary under the provisions of the Act, other provisions not in the Act itself but rather in the miscellaneous provisions of the NDAA (of which the Act is one part) require continuing studies on beneficial ownership information reporting requirements.

Effectiveness of Incorporation Practices. First, not later than two years after the effective date of regulations implementing the beneficial ownership information reporting requirements under the Act, the Comptroller General is to conduct a study and submit to Congress a report regarding the effectiveness of the incorporation practices implemented, with respect to:

- providing national security, intelligence, and law enforcement agencies with prompt access to reliable, useful, and complete beneficial ownership information; and

- strengthening the capability of national security, intelligence, and law enforcement agencies to (a) combat incorporation abuses and civil and criminal misconduct; and (b) detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes.

Using Technology to Avoid Duplicative Reporting and Increase Accuracy. Second, the Secretary, in consultation with the Attorney General, is to conduct a study to evaluate the effectiveness of using FinCEN identifiers or other simplified reporting methods in order to facilitate a simplified beneficial ownership regime for reporting companies. The report is also to include an evaluation of whether a reporting regime, with reporting of only company shareholders within the ownership chain of a reporting company, could effectively track beneficial ownership information and increase information to law enforcement. This evaluation is to include an assessment of the costs of imposing new verification requirements on FinCEN and the resources needed to implement such changes.

Non-reporting Entities. Third, within two years after the effective date of implementing regulations, the Comptroller General, in consultation with the Secretary, the Attorney General, the Secretary of Homeland Security, and other regulators and members of the intelligence community, is to conduct a study and submit a report to Congress that reviews the categories of entities excluded from the scope of reporting entities. The report is to review the regulated status, related reporting requirements, quantity, and structure of each class of entities. The study is to include an assessment of the extent to which any excluded entity or class of entities pose significant risks of money laundering, the financing of terrorism, proliferation finance, serious tax fraud, and other financial crime. The study will also identify other policy areas related to the risks of exempting entities from reporting for Congress to consider in its oversight of these beneficial ownership information reporting requirements.

Other Legal Entities. Finally, also within two years after the effective date of implementing regulations, the Comptroller General is also to conduct a study and

report to Congress regarding other legal entities, including partnerships and trusts. The report would include:

(1) identification of each State that has procedures that enable persons to form or register under the laws of the State partnerships, trusts, or other legal entities, and the nature of those procedures;

(2) identification of each State that requires persons seeking to form or register partnerships, trusts, or other legal entities under the laws of the State to provide beneficial owners or beneficiaries of those entities, and the nature of the required information;

(3) evaluation of whether the lack of available beneficial ownership information for partnerships, trusts, or other legal entities: (a) raises concerns about the involvement of those entities in terrorism, money laundering, tax evasion, securities fraud, or other misconduct; and (b) has impeded investigations into entities suspected of the misconduct;

(4) evaluation of whether the failure of the United States to require beneficial ownership information for partnerships and trusts formed or registered in the United States has elicited international criticism; and

(5) what steps, if any, the United States has taken, is planning to take, or should take in response to such criticism.

The Act itself leaves open the possibility that implementing regulations could include within the scope of the terms "reporting company" partnerships or at least potentially certain types of trusts (such as statutory trusts). However, the requirement to study other legal entities, including trusts and partnerships, implies that these may not fall within the scope of reporting companies yet, at least pending completion of this study. Nevertheless, the status of partnerships and trusts as reporting entities under any implementing regulations remains uncertain. In particular, certain types of trusts, such as statutory trusts as well as certain investment and business trusts, may be treated in the regulations similarly to corporations as they are for tax purposes. Analogous treatment for AML purposes may place them within the scope of the Act. It is not clear whether Treasury would take such an approach, similar to foreign bank account reporting, which utilizes existing certain US federal tax concepts in the AML context.

In any case, the requirement to study these entities seems to indicate that Congress is not yet fully opening the gates to trust registers and other types of company registers and reporting as are already available in many other jurisdictions. These further studies will bring Congress at least a significant step closer to implementing additional measures in line with such international standards regarding not only corporations and similar legal entities but also partnerships as well as trusts. Congress is already aware of international developments and the OECD and FATF guidance and recommendations as well as EU implementation in this area and more broadly with respect to beneficial ownership reporting in the fight against tax evasion, money laundering and terrorism financing.

Additional US Transparency Measures

The introduction of beneficial ownership reporting requirements for corporations, LLCs, and other similar entities under the Act continues recent legislative measures designed to increase the disclosure of foreign persons transacting in the United States.

IRS – Information Return of a 25% Foreign-Owned US Corporation or Foreign Corporation Engaged in US Trade or Business

Back in 2016, the US Treasury and the IRS promulgated regulations that required single-member US LLCs to disclose their foreign direct or indirect owner(s) on IRS Form 5472 and report transactions between the LLC and the non-US owner. Similar obligations existed already for US corporations or non-US corporations with a US trade or business where a non-US shareholder owns directly or indirectly 25% or more in the corporation.

IRS – Form 1065 Schedule B-1, Information on Partners Owning 50% or More of Partnership

For US federal tax purposes partnerships have to report information on partners owning directly or indirectly an interest of 50% or more in the profit, loss, or capital of the partnership. This reporting applies to any US or non-US partner that is an individual, estate, corporation, partnership (including any entity treated as a partnership), trust, tax-exempt organization, or non-US government.

The 50% owner reporting must be done annually on IRS Form 1065 Schedule B-1 by each partnership formed

- in the United States if it receives income or incurs any expenditures treated as deductions or credits for US federal income tax purpose or

- outside the United States if it has gross income (A) effectively connected with the conduct of a US trade or business or (ii) derived from US sources above $20,000.

The IRS may use this information on 50% partnership ownership, as well as the above-mentioned 25% ownership of LLCs and corporations, for tax enforcement purposes and also may exchange it upon request by non-US tax authorities.

FinCEN – FBAR

Since 1970, US citizens and residents have been required to disclose their financial interests in foreign bank and financial accounts first on Form TD F 90-22.1 which then became FinCEN Form 114 (referred to as the Report on Foreign Bank and Financial Accounts or "FBAR"). , In addition to individuals, these FBAR filing obligations also extend to corporations, partnerships, and LLCs created or organized in the United States or under the laws of the United States as well as trusts or estates formed under the laws of the United States.

FinCEN – Geographic Targeting Order (GTO)

Last November FinCEN also renewed its Geographic Targeting Orders (GTOs) that require US title insurance companies to identify the natural persons behind shell companies used in all-cash non-financed purchases of residential real estate. Reporting applies to properties with purchase price $300,000 or more in certain counties in the following 12 US metropolitan areas: Boston, Chicago, Dallas-Fort Worth, Honolulu, Las Vegas, Los Angeles, Miami, New York City, San Antonio, San Diego, San Francisco, and Seattle. The transaction is reportable if the purchase is made by a legal entity, without a bank loan or similar external financing, and using (at least in part) currency or a cashier's check, a certified check, a traveler's check, a personal check, a business check, a money order in any form, a funds transfer, or virtual currency. The reporting must be done within 30 days of closing by the title insurance company involved in the transaction closed during the period from November 6, 2020 to May 4, 2021.

Bureau of Economic Analysis reports

In addition to the obligations under the purview of the US Treasury's IRS and FinCEN, the US Department of Commerce's Bureau of Economic Analysis ("BEA") requires annual, quarterly, and other benchmark reports and surveys related to US investment aboard and foreign investment into the United States. In particular, all US persons may be required to report their direct or indirect ownership of a foreign affiliate on a quarterly basis (Form BE-577), an annual basis (Form BE-11), or as part of the BEA's benchmark survey every five years (Form BE-10). Similarly, US business enterprises with direct or indirect foreign ownership may be required to report when the foreign inbound investment is made (Form BE-13), on a quarterly basis (Form BE-605), on an annual basis (Form BE-15), or as part of another benchmark survey (Form BE-12).

EU AML Approach

As mentioned above, the United States is in effect catching up with other jurisdictions in ensuring that the beneficial owner information is available promptly. The Act creates similar, but not identical, reporting obligations already in existence in the EU and the UK. In 2015 the EU 4th Anti-Money Laundering Directive came into force requiring registers with such information. Further back in January 2009, for example France published Order No. 2009-104 on the prevention of the use of the financial system for the purpose of money laundering and to counter terrorist financing, transposing the European Council Directive No. 2005/60/CE of October 2005. Afterwards, through a June 12, 2017 Decree, France established a register and set forth new reporting obligations regarding the "ultimate beneficial owner" of newly created registered entities.

Furthermore, the EU 5th Anti-Money Laundering Directive (EU) 2018/843 (the "5AMLD") had to be transposed by the EU Member States into national law by January 10, 2020 in order to establish publicly accessible national registers of beneficial ownership of legal persons (except trusts). These registers have to contain adequate, accurate and up-to-date information through dedicated processes aimed to ensure the publicity, data quality and accessibility of the registers. The 5AMLD also broadened the criteria for the identification of high-risk third countries, including the availability of information on the beneficial owners of companies and legal arrangements. The EU developed its own methodology

based on information from the FATF, EU expertise and other sources such as Europol in order to identify countries with deficiencies that pose significant threats and risks to the EU financial system. The EU reviewed the United States, among other countries, but did not include it in the list of high-risk countries. Among the 23 jurisdictions on the list are American Samoa, Guam, Puerto Rico, and US Virgin Islands. The US Treasury protested against their inclusion due to the commitments and actions of the United States in implementing the FATF standards, which extend to all US territories as the same AML legal framework that applies to the continental United States also generally applies to US territories. It is possible that these developments prompted the US Treasury to highlight to Congress the need to improve the collection of information and enact the Act into law.

Conclusion

The Act brings the United States in line with the EU as well as other OECD and FATF member countries to have available promptly upon request basic beneficial ownership information for certain legal entities. However, while the Act is already in force, the US Treasury must first promulgate regulations in 2021 in order to clarify the above-mentioned questions most importantly which entities should report and who should be treated as applicants and beneficial owners among other uncertainties. Any reporting company that has been formed, or foreign company registered to do business, in the United States before the effective date of these regulations will have 2 years to report the necessary information. Therefore, the deadline for reporting by such *existing* companies should be latest in 2023. New companies will have to submit the report to FinCEN at the time of formation or registration after the effective date of the regulations and thus it can be expected sometime in 2021. Afterwards, the IRS and non-US tax authorities for purposes of enforcement as well as financial institutions for their KYC due diligence should be able to obtain upon request (not automatically) from FinCEN the basic information of beneficial owners available under the Act. We expect that partnerships and trusts will not be covered by this reporting for AML purposes to FinCEN until after the mandatory survey and report to Congress. Eventually, following the example of the EU and UK, such information may become publicly available, at least upon legitimate request from interested parties.

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